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CFEP DRAFTING GROUP
ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 10
Draft of June 22, 1955

Possible **Imposition of Financial (blocking and import) Controls vis a vis the Soviet Bloc Countries Other than Communist China**

Econ. Impact of Extension of Financial Controls

This draft of Staff Study No. 10, "Imposition of Financial (blocking and import) Controls vis a vis the Soviet Bloc Countries Other Than Communist China", is transmitted for your use in connection with the work of the CFEP Drafting Group on Economic Defense Policy Review.

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Executive Secretary

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(Contributed by Treasury, Commerce)

Possible Imposition of Financial (blocking and import) Controls vis a vis the Soviet Bloc Countries Other Than Communist China

"Treasury controls" or at least "U.S. Financial Controls" i.e., there are other forms of financial controls (chiefly foreign exchange controls). Furthermore, import controls are not financial controls except in an institutional sense.

1. Historical

(A) The United States imposed blocking controls prior to and during World War II first as a measure to protect the dollar assets of the invaded countries, and later as an economic warfare measure against the Axis powers.

Freezing or blocking controls were first initiated in April 1940, when Germany invaded Norway and Denmark. The President, by Executive Order No. 8389, prohibited transactions involving Norwegian and Danish property within the United States except as authorized by the Secretary of the Treasury. As other countries were invaded or dominated by the Axis, the Control was successively extended during the summer and fall of 1940 to the assets of the Netherlands, Belgium, France and the Baltic and Balkan States. In June 1941, the Control was extended to Germany and Italy and to the rest of continental Europe. On July 26, 1941, when Japan overran Indo-China, the Control was invoked against Japan. At the same time, freezing control was extended to China at the specific request of Generalissimo Chiang Kai-shek in order to assist China in the control of its economy and in order to prevent Japan from using the

[redacted]

occupied areas in China as a loophole for evading freezing control. After the United States entered the war the blocking controls were extended automatically to all Japanese occupied areas in the Far East.

At its inception, the Foreign Funds Control of World War II had as its primary purpose the protection of the assets within the United States of invaded countries in order to prevent their falling into the hands of the invaders and in order to protect American institutions from possible adverse claims. As the international crisis deepened, the blocking control was used as a weapon of economic warfare directed against the Axis powers through severing all financial and commercial intercourse, trade and communication, direct or indirect, between the United States and the Axis and Axis-dominated countries, and preventing all financial and commercial intercourse and trade between the United States and any foreign country which directly or indirectly benefited the Axis.

At the end of World War II the blocking controls were lifted from the assets in the United States of the formerly occupied countries. The United States assets of the chief enemy countries, Germany and Japan, were vested by this Government in the Alien Property Custodian. The World War II assets in this country of the Axis satellites, Rumania, Hungary and Bulgaria, which are now Soviet satellites, are still blocked under the jurisdiction of the Justice Department (which succeeded the Treasury as administrator of World War II blocked property) but assets accruing to these countries since December 1945 are not blocked at present. The World War II assets of Latvia, Lithuania and Estonia and some Polish and Czech assets are likewise still under Justice Department blocking controls. The World War II controls were, in effect, not applied to assets of the U.S.S.R.

Separate controls over imports of merchandise originating in Axis held territory were unnecessary during the World War II period since such products were prevented from reaching the United States by the Allies naval blockade.

(B) Imposition of controls vis a vis Communist China and North Korea in December 1950.

The present blocking regulations, the Foreign Assets Control Regulations, were one of the economic warfare measures taken by this Government in December 1950 when the Chinese Communists intervened in Korea. These Regulations were intended to deprive Communist China and North Korea of foreign exchange which could be used in support of their aggression. The Regulations block all property in the United States in which there exists any Communist Chinese or North Korean interest and prohibit all trade or other financial transactions with those countries.

Imports of goods of Communist Chinese and North Korean origin are prohibited as a part of this program to deny China foreign exchange. Moreover, in order to effectuate this policy, the Control has found it necessary to prohibit the unlicensed importation of various types of merchandise historically imported from China, regardless of the alleged place of origin of the merchandise. These restrictions have been imposed because of the extent to which products of Communist China had been misdescribed as the growth or product of some other country in an effort to evade the Regulations.

2. Legal Authority. Statutory authority now exists for Secretary of the Treasury to impose blocking and import controls under Section 5(b) of the Trading with the Enemy Act.

By Executive Order 9193 the President has conferred upon the Secretary of the Treasury all powers and authority vested in the President by §§ 3(a) and 5(b) of the Trading with the Enemy Act (40 Stat. 412, 415, as amended; 50 U.S.C. App. (3) (a) and (5)). This delegation carries with it responsibility in time of national emergency for the regulation, where required, of all dealings in property subject to the jurisdiction of the United States in which any foreign country or national has any interest and of all trade and financial transactions with such countries or persons.

The Foreign Assets Control Regulations were issued pursuant to this statutory authority following the declaration of a national emergency by the President on December 16, 1950. The same statutory authority may be utilized to impose blocking and import controls on the other Soviet bloc countries if desired.

3. Objectives and Basic Concepts of this Control Mechanism.

While the United States has since December 1950 imposed blocking and import controls on Communist China and North Korea (as well as a virtual export embargo) such controls have not been imposed on the assets of and import from the countries of the European Soviet Bloc. In the case of the European Soviet Bloc countries the United States has thus far been concerned only with denying to such countries goods of significance to the Bloc's war potential and for this purpose has chosen as its primary instrument international security export controls.

Certain basic questions which would be involved in extending blocking and import controls to the countries of the European Soviet Bloc would seem to require some discussion before considering the economic impact of such controls on the Bloc and certain administrative problems which would be involved in such an extension of these controls. The questions are the following:

(A) Is the economic purpose in the case of the Soviet Bloc, as in the case of Communist China, to deny foreign exchange so as to prevent acquisition of goods and services therewith?

The primary economic purpose of imposing blocking and financial controls on Communist China and North Korea is to deprive those countries of foreign exchange--through immobilizing the dollar assets they hold in the United States; closing the important United States market to their goods; and cutting off the exchange which normally would accrue to the Communist authorities if persons in the United States could freely continue to send support and other remittances to persons in China.

Although the European Soviet Bloc does not have as many unblocked assets here as Communist China did prior to our blocking that country's assets and is not dependent on the United States market for its exports to the extent the Chinese were, the economic warfare objective in extending the blocking and import controls to the European Soviet Bloc would be the same as in the case of Communist China, namely to deal as hard a blow to their economy as we are capable of through action which deprives them of needed foreign exchange with which they might otherwise acquire goods and services in the United States and abroad. This is not to say that in any

extension of these controls to the European Bloc this economic warfare objective would be the paramount consideration involved. Indeed, political and psychological aspects would probably be of considerably more importance in any determination to extend these controls. However, aside from any political and psychological reasons for imposing blocking controls on the European Soviet Bloc our economic purpose would be to deal a blow to their economy, through depriving them of foreign exchange.

It has been suggested that blocking the European Soviet countries might be done to prevent them from using their dollar assets and earnings for propaganda and subversion and to prevent them from financing in dollars imports into the Bloc from third countries of strategic goods, while non-inimical uses of their dollar assets could be licensed. It would be difficult if not impossible to operate an effective blocking control which would achieve these objectives. In licensing transactions considered not inimical to the United States, the licensing authority would have to rely in the main on either representations made to it by Bloc applicants or on onerous investigations. The only operationally feasible approach would appear to be a firm policy of denying all applications for licenses to use Bloc assets except in unusual circumstances. This would probably amount to denying use of Bloc assets in almost all cases so that we would wind up with close to complete blocking.

Moreover, even the most rigid blocking would not eliminate cloaked assets and transactions. Propaganda and subversive activities could still be financed from assets cloaked in the names of nationals of friendly foreign countries and in the names of secret agents in the United States.

Blocking controls likewise would not preclude cloaked illegal strategic trade dollar transactions financed through institutions in non-blocked countries, where the transactions are cloaked and neither the bank abroad nor the U. S. bank holding the cover dollar account is aware of the purpose of the payment. In short, direct enforcement could hamper, but not prevent, cloaked activities.

The blocking and import controls, however, would, through the denial of foreign exchange to the European Soviet Bloc countries, have some effect on undetected cloaking activities. Since the Bloc would have less exchange available for goods and services some subversive activities and some clandestine strategic trade might be eliminated as a by-product of the denial of exchange to the Bloc.

The basic economic warfare objective that a blocking and import control directed at the European Soviet Bloc countries could have would therefore appear to be a denial of dollars to the Bloc to prevent their obtaining goods and services anywhere in the Free World through their trade and financial transactions with the United States.

(B) Are there difficulties conceptually in having import controls without blocking Soviet Bloc assets here and without preventing non-trade remittances to the Bloc?

It would be difficult to justify a program having as its objective the denying of foreign exchange to the European Bloc countries if the United States merely banned imports but at the same time allowed these countries the free use of their dollar balances here and placed no restraint on the transmission of funds by Americans to these countries. There would appear

to be no logical answer to queries from the public asking why, if the U. S. was interested in depriving the Bloc of foreign exchange, it did not take all effective measures at its disposal to accomplish this objective and not just impose controls on imports. United States importers affected by import restrictions under such circumstances could and undoubtedly would complain. They would allege discrimination since they could not buy goods from the Bloc and make payment therefor although other Americans could freely make any type of payment they wished to the Bloc countries such as for services or support remittances without let or hindrance. They would point out that the dollars accruing to the Bloc in this fashion, though perhaps not as voluminous as those which it might derive from United States imports, were nonetheless valuable dollars to the Bloc.

(C) Is it illogical, when viewed solely from an economic defense standpoint, to have selective import controls with possible exception of allowing certain strategic imports for overriding reasons?

While it might be easier as a purely administrative matter for the United States to impose import controls on a limited number of Soviet Bloc products--for example on the Bloc's larger dollar earners--such selective import controls would be difficult to justify assuming the U. S. objective in imposing controls is to limit the purchasing power of the Bloc. In the short run the imposition of restrictions on the most important exports of the Bloc to the U. S. would deprive the Bloc of substantial dollar exchange. However, depending on the importance of such loss of exchange to the Bloc and whether a market could be found here for other products, the Bloc might

within a reasonable time substitute unrestricted products for their restricted imports. This would then necessitate our imposing new import restrictions after each significant change in the composition of Bloc exports to the U. S. if we wish to keep down their dollar earnings.

Additionally, and probably more important, since selective import controls would affect only those import businesses concerned with the controlled commodities and the importers from the Bloc of unrestricted commodities would not be affected, such a policy would be difficult to justify to the United States importers of restricted commodities. If our reason for imposing import controls is to deny exchange to the Bloc there is no reason for singling out a particular group of importers to bear the burden of the control, other than perhaps administrative convenience which is not likely to be a convincing reason for the discrimination.

However, it would appear to be defensible to allow some Bloc imports to come in while others are excluded if the basis for the admission is overriding defense considerations. In the case of our present Communist China import controls at one time we licensed imports of certain Chinese commodities held by the Defense Department to be essential to the defense effort--it being felt that our obtaining the commodity was more important to the U. S. than the fact that the Communists obtained foreign exchange therefor. However, short of such a justification it would be difficult to defend publicly a program which allowed some commodities to come in and kept others out so long as our reason for keeping some commodities out is damage to the Bloc through their loss of dollar earnings.

If the U. S. were to exclude certain Soviet Bloc commodities for a purpose other than to deny the Bloc the dollar proceeds of such sales as for example import restrictions imposed for essentially protective tariff reasons or to prevent the U. S. from unduly relying on imports of certain commodities from the Bloc, such a program could be defended logically. However, this could not be justified on the ground their purpose is to hurt the Bloc through deprivation of dollar purchasing power.

(D) Do blocking controls including import controls imply a cessation of exports to the Soviet Bloc too except to extent we are willing to allow innocuous exports for "free exchange"?

If the economic purpose of imposing blocking and import controls on the European Soviet Bloc is to deprive these countries of foreign exchange with which they can freely acquire goods and services both in this country and abroad it would be consistent with this objective to license such exports to the European Soviet Bloc as we may desire provided they are willing to pay for such U. S. exports with new funds remitted from abroad for such purpose. This is the situation which exists at present with respect to the exporting of publications to Communist China, virtually the only exports the U. S. is willing to allow to go to that country. A Department of Commerce general license authorizes the export of publications to Communist China but the applicable Treasury general license only authorizes payment therefor from new free funds remitted to the U. S. for this purpose by the Chinese Communists.

If the U. S. objective in imposing import controls was not to deprive the European Soviet Bloc of the use of all foreign exchange, in so far as

it is in our power to do so, but merely to control the use of the Bloc's dollar earnings we could permit non-strategic exports to the Bloc to be paid for from their blocked assets. Under such a program it would be possible to license exports of non-strategic commodities to the Bloc if payment were made from blocked accounts established with the proceeds of imports from the Bloc which have been licensed. This, however, would not be a U. S. control for the purpose of denying utilization of Bloc earnings from transactions with the U. S. It would be allowing the Bloc to utilize such assets and earnings for such exports as we are willing to permit, and more importantly, which the Bloc deems it in its interest to acquire through the proceeds of its exports to the U. S. Moreover, it would be unlikely that if the European Soviet Bloc were blocked, but with the privilege of using the proceeds from its exports to the U. S. for certain U. S. goods, they would be willing to export goods to the U. S. to acquire blocked dollars. For the value to them of such blocked dollars would be limited to obtaining certain innocuous merchandise which they could probably obtain anywhere in the world and where they would not be in as much danger of losing the use of the blocked proceeds of their exports if the U. S. later decided to impose a more severe blocking control. Even if we were to permit the utilization of the proceeds of Bloc exports to the U. S. to pay for authorized U. S. exports to the Bloc, it would not be logical to allow the Soviet Bloc to use its blocked assets not accruing from current transactions for exports to the Bloc, however innocuous, since the result of such a policy would be that any pressure which the blocking of these funds might otherwise have had would be substantially dissipated.

It would seem, therefore, that if the U. S. objective in imposing blocking and import controls is to deprive the Bloc of what it would be able to acquire with its dollar assets and earnings it necessarily follows that they should not be allowed to acquire any goods whether they be U. S. exports or not with any of their assets or earnings. For if we allow the Bloc to use dollar earnings to pay for U. S. exports we should recognize that while we are controlling their imports into the U. S. so that they may only acquire therewith U. S. goods which we desire to sell them, these goods must also be the commodities they desire to buy from us or they would not allow exports to the U. S. in payment. Such a controlled system of U. S. Soviet Bloc trade would also necessitate our forcing into Soviet Bloc trade channels those Bloc exports to the U. S. that normally move here through third countries. We could not allow indirect imports from the Bloc through third countries since they would be acquiring free exchange with their sales of such goods in third countries, while if they sold to the U. S. directly the proceeds of the exports to the U. S. would be blocked. We would have to bar such indirect imports in any scheme to tie their imports into the U. S. with their purchases from the U. S. Of course, if our import controls were enforced to bar any useful employment of Soviet Bloc foreign exchange earnings this indirect trade would have to be banned too.

In summary it may be said that to the extent that U. S. exports are allowed to the Bloc for its dollar earnings we are softening the impact which our import controls could have on the Bloc if they were used to deprive the Soviets completely, rather than partially of the U. S. market for these goods.

(E) Is it feasible to impose selective import controls to promote primarily non-economic defense U. S. objectives, such as allowing certain imports only if the proceeds are utilized for purchases of U. S. agricultural surpluses?

As pointed out above, allowing the Soviet Bloc to buy with the dollar earnings from its exports to the U. S. some selected goods from this country (in essence U. S. exports agreed to by both the U. S. and the Bloc) is not logical if our aim is to deliver the maximum economic blow to the Bloc which can be brought about through the imposition of import controls.

However, if the purpose of the U. S. in imposing import controls is something other than to deprive the Soviet Bloc of goods useful to it through curtailing its foreign exchange earnings, import controls might be appropriately used in conjunction with selective export controls. For example, if it were determined to be U. S. governmental policy to promote the sale of agricultural surpluses to the Soviet Bloc we might bar imports from the Bloc unless their proceeds were used to purchase such U. S. agricultural commodities. Of course, if the Bloc did not wish to utilize exports to the U. S. for the agricultural commodities this procedure would not work. But if the Bloc were willing to acquire the commodities in question in exchange for its exports to the U. S.--import controls and controls blocking the proceeds of such imports except as released for agricultural purchases could be used as a mechanism to effectuate such a program.

This, however, would not be a program to deprive the Bloc of the purchasing power of its dollar earnings. It would merely be a plan to give it only those goods for its dollar earnings that the U. S. wished to sell to it and which

would only be bought by the Soviet Bloc with its dollar earnings if the Bloc considered it to be to its advantage to do so. If it did not, there would be no U. S. imports from the Bloc and accordingly no sales of agricultural surpluses to the Bloc.

4. Administrative Problems involved in Extension of Controls.

(A) Difficulty of blocking assets of and preventing dollar transactions by Soviet agents and cloaks located in friendly foreign countries.

If the blocking controls were extended to the European Soviet Bloc countries the assets here of agents and cloaks of the Bloc who live in friendly foreign countries would be technically blocked under the Regulations but in practice their American assets would not be blocked unless the Government or the American financial institution had reason to believe that the person was a Bloc agent or cloak. Satisfactory information that such persons were agents or cloaks would usually be difficult to come by for it must be remembered that a national of the United States or of a friendly country cannot be blocked on mere suspicion.

There might also be involved difficulties with friendly foreign countries if the U. S. should block some of their nationals, as nationals of a Soviet bloc country. This is obvious in the case of ostensibly respectable businessmen. Even blocking a notorious Communist leader in one of the Western European countries on the ground that he is an agent of the U.S.S.R. might be a cause of friction between this country and the country concerned, which the Bloc would be certain to exploit.

(B) Difficulty of controlling certain imports from the Bloc physically indistinguishable from imports from friendly countries.

In the case of Communist China the U. S. import controls are relatively easy to enforce because Chinese exports to the U. S., by and large, are raw materials physically distinguishable in many cases from similar raw materials produced elsewhere; European bristles for example can generally be distinguished from Chinese bristles. Imports to the U. S. from the Bloc countries, however, particularly from some of the satellites, would involve many different manufactured products indistinguishable from similar products made in Western European countries. In the Far East the U. S. has entered into agreements with the principal countries, such as Hong Kong, Japan, and Formosa, whose products are similar to Communist China's, under which these governments certify to the U. S. that their exports to the U. S. of Chinese type goods are not in fact of Communist Chinese origin. Imports so certified are admissible into the U. S. under a general license. Such certification procedures have only had to be set up with a relatively small number of countries and commodities. The Czechs have been exporters to the U. S. of semi-precious stones and the East Germans of considerable amounts of photographic equipment. In order to prevent such products from continuing to enter the U. S. through other countries in Europe masquerading as the products of such countries it would probably be necessary to bar similar products from all European countries in the absence of a certification procedure, as described above. It may well be that it would be an impossible burden on the trade between the U. S. and the Western European countries to

set up such certification procedures for all Soviet Bloc type products. To the extent such procedures were not or could not be set up there would be avenues through these countries for some products of the Soviet Bloc countries to continue to reach the U. S.

5. Economic impact of application by U. S. of financial (blocking and import) controls on Soviet Bloc other than Communist China.

(A) Estimate of magnitude of balances in U. S. which would be blocked.

In the absence of taking an actual census of the unblocked assets which the European Soviet Bloc countries now hold in this country only rough estimates can be made of the magnitude of such assets. The following table gives such an estimate for all the countries of the European Soviet Bloc, to wit, Albania, Bulgaria, Czechoslovakia, Estonia, East Germany, Hungary, Latvia, Lithuania, Poland and Danzig, Rumania and the U.S.S.R. These unblocked assets, estimated to amount to $21 million, would be affected by the imposition of new blocking controls. It should also be noted that there are presently blocked subject to the World War II blocking controls administered by the Office of Alien Property of the Department of Justice approximately $50 million in assets of certain of these European Soviet Bloc countries, to wit, Rumania, Hungary, Bulgaria, Latvia, Lithuania, Estonia, Poland and Czechoslovakia. In addition, approximately $9 million in Czechoslovakian assets are now blocked under Treasury controls, representing the proceeds of the sale of a Czech steel mill.

Estimated Unblocked Dollar Assets of Eastern European Countries in the United States as of Latest Available Date

(In thousands of dollars)

	Total	Bank Assets 1/	Other 2/
Albania..................	192	192	3/
Czechoslovakia...........	1,162	682	480
Poland and Danzig........	2,442	2,427	15
Rumania..................	404	3/	404
U.S.S.R..................	1,830	1,549	281
Total Short-Term......	6,030	4,850	1,180
Long-Term 4/........	15,000		
Total Dollar Assets...	21,030		

Note: Short-term assets of Eastern European countries not listed appear to be largely blocked. Data on holdings through third countries not available.

1/ As reported by United States banking institutions as of March 31, 1955, except for Albania which is as reported by banks in the Second Federal Reserve District as of December 31, 1954. Less estimates for blocked balances derived largely from OAP-700 data.
2/ As reported by United States commercial and industrial concerns and brokers as of December 31, 1954.
3/ Not available but believed to be negligible.
4/ Not available by country. Estimate based on United States international investment position data as prepared by U. S. Department of Commerce and on data from Treasury Department capital movements forms.

Source: Treasury Department Forms B-1, C-1/2, S-4, and S-1/3
Office of Alien Property Form OAP-700
Department of Commerce, Survey of Current Business, May 1954.

It will be noted that the above estimate of approximately $21 million does not include assets of the European Soviet Bloc countries held here indirectly through accounts in the names of banking institutions in third countries. It is not possible to estimate the amount of such assets and the ownership of some portion thereof might be so well concealed that such assets would not be affected by blocking controls imposed on the European Soviet Bloc countries and their nationals.

(B) Estimate of magnitude of loss to bloc through U. S. ban on imports of goods of Soviet Bloc origin.

(i) Value of U. S. imports from the Bloc.

The magnitude of U. S. imports of goods of European Soviet Bloc and Outer Mongolian origin for the years 1952-1954 is shown in the following table.

U. S. Imports for Consumption from Soviet Bloc Countries
1952 - 1954
(In thousands of dollars)

	1954	1953	1952
Total	50,136	42,260	47,222
Albania	8	65	52
Bulgaria	325	338	296
Czechoslovakia	2,960	1,924	1,531
Eastern Germany	4,470	5,356	6,732
Estonia	-	-	*
Hungary	1,309	1,527	2,894
Latvia	-	-	*
Lithuania	1	-	1
Poland and Danzig	21,512	13,971	10,347
Rumania	381	275	638
U.S.S.R.	11,785	10,780	16,731
Outer Mongolia	7,385	8,024	8,000 1/

* Less than $500.

1/ Not available separately; estimated on basis of 1953 figure.

Source: Bureau of the Census, FT 110

The Bureau of the Census and Bureau of Customs ordinary definition of "country of origin" is the basis for these statistics. The Treasury's Foreign Assets Control in administering its import controls vis-a-vis Communist China also regards as of Communist Chinese origin products of that country which are processed in third countries, even though such products would not be regarded as of Communist Chinese origin under the usual Bureau of Customs and Bureau of the Census interpretation of that term (See 5 (C) infra)

The following table shows the principal U. S. imports from the Soviet Bloc countries other than China, with a breakdown by countries for the years 1952 and 1953.

Principal U. S. Imports for Consumption from Soviet Bloc Countries, 1952 and 1953
(In thousands of dollars)

	1953		1952	
	Amount	% of Total	Amount	% of Total
Albania	65		52	
Furs, unmanufactured	65	100	52	100
Bulgaria	338		296	
Veg. oils & waxes, inedible	243	72	226	76
Czechoslovakia	1,924		1,531	
Semi-precious stones	644	33	147	10
Coal-tar products	326	17	72	5
Furs & Mfrs	138	7	172	11
Animal & animal products, inedible, n.e.s.	3	-	347	23
Eastern Germany	5,356		6,732	
Fertilizer	2,695	50	2,727	41
Photographic goods	1,316	25	1,911	28
Hungary	1,527		2,894	
Animal & animal products, inedible, n.e.s.	757	50	1,293	45
Poland and Danzig	13,971		10,347	
Meat products (hams & bacon)	10,545	75	7,244	70
Animal & animal products, inedible, n.e.s.	1,180	8	1,466	14
Hides & skins	986	7	395	4
Rumania	275		638	
Animal & animal products, inedible, n.e.s.	100	36	256	40
Furs & Mfrs	37	13	287	45
U.S.S.R.	10,780		16,731	
Furs & Mfrs	7,068	66	12,304	74
Animal & animal products, inedible, n.e.s.	1,011	9	903	5
Outer Mongolia	8,024		(	
Wool, unmanufactured	5,599	70	(n.a.	
Furs & Mfrs	2,310	29	(	

Source: Bureau of the Census, FT110, FT120.

The following table shows a further commodity breakdown of imports from the entire European Soviet Bloc for the years 1952, 1953 and 1954 and furnishes for comparison purposes a commodity breakdown of imports from the Bloc for the year 1948.

U. S. Imports from Soviet Bloc Countries in Europe: 1948, 1952, 1953 and 1954
(In thousand dollars)

Commodity	European Soviet Bloc 1948	1952	1953	1954
Imports for consumption	115,354	39,268	34,354	42,639
Meats and sausage casings	919	4,782	10,653	17,726
Fish products including shell fish	696	585	334	384
Other foodstuffs	461	546	496	279
Furs and manufactures	42,154	13,048	7,416	8,595
Bristles	242	1,275	1,286	860
Feathers, crude	1,714	2,970	1,768	954
Tobacco, unmanufactured	4,281	5	36	21
Hops	3,058	-	-	-
Tung oil	-	-	-	-
Cotton waste	473	218	20	211
Raw cotton and linters	1,985	776	562	781
Wool, unmanufactured	1,181	-	-	208
Hair and manufactures	506	338	369	224
Silk waste	117	142	32	270
Other textiles and manufactures	1,831	795	621	1,148
Glass and glass products	2,421	1,202	715	913
Pottery and clay products	173	296	142	55
Precious and semiprecious stones, imitations & industrial diamonds	3,569	153	655	493
Manganese ore	8,243	-	-	-
Chrome ore	14,024	-	-	-
Tungsten ore	-	-	-	-
Tin	-	-	-	-
Antimony	-	127	-	-
Precious metals, jewelry and plated ware	3,083	11	660	239
Fertilizers and fertilizer materials	798	2,746	2,849	1,487
Fire works	-	-	-	1
Photographic goods	44	1,916	1,353	1,784
Artworks and antiques	19	117	94	58
Beads and fabrics and articles of beads	2,646	20	251	449
Vessels returned (Lend Lease)	7,855	-	-	-
All other imports	7,866	4,201	4,085	5,499

Source: Based on data prepared by the International Economic Analysis Division, Dept. of Commerce, May 23, 1955

(ii) Estimate of amount of such goods denied import into the United States which could be sold in other markets and amount realisable by the Bloc thereon.

An examination of the make-up of goods imported from the Bloc in 1954 indicates that alternative markets in lieu of the U. S. will probably not be readily found. A review of the individual commodities, on an item by item basis, suggests that underdeveloped areas may be disregarded in considering possible alternative markets for these goods. Underdeveloped areas do not require raw materials, pork products, furs or Christmas tree ornaments. The utilization of commodities exported by the Bloc to the United States requires an economy with a pattern of consumption similar to that of the United States--namely Western Europe, the U. K. and Canada.

Meat and other foodstuffs imported by the U. S. from the Soviet Bloc amounted to $18.4 million, of which $17.7 million were pork products, $0.4 million fish products and $0.3 million other foodstuffs. U. K. demand for protein foods is high. In 1954 the U. K. imported $30.9 million (cif basis) worth of Polish pork products of which $28.4 million was bacon. It appears reasonable to assume that the U. K. could expand its imports of these Polish pork products provided the price is right and it is also reasonable to assume that the U. K. would pay a lower price for these products than the U. S. For working purposes, we may take the earnings from sales in the U. K. at about 70 percent of the present level of sales in the U. S.

By comparison with meat, it is difficult to envision possible markets for the remaining $32 million worth of European Soviet Bloc and Outer Mongolian goods. Furs, amounting to $9.2 million, do not appear to be readily marketable in Western Europe. London is a world market for furs but there is no real additional (consumption) demand in Western Europe, U. K. and Canada for this commodity, especially under the Treasury concept of country of origin. Fertilizer, worth about $1.5 million may be a marketable item in these areas. Cashmere hair, amounting to $5.4 million, would be saleable in Western Europe (including U. K.) and a substantial quantity of the manufactured product of this material could be exported to the U. S. (e.g., sweaters or coats). In order to sell their commodities in Free World markets, the Bloc suppliers would be forced to compete with Free World suppliers of the same types of commodities; this would of necessity result in price cutting by the Bloc seller. It would appear, even if prices were significantly lowered, that the Bloc could sell in other markets only minor quantities of products outside the food group. In all, probably 50 percent of their present sales, or $25 million, would be a maximum estimate of what the Bloc countries could realize for the goods currently exported to the U. S. market.

(C) Estimate, if possible, the loss to the Bloc if the United States ban on imports extended not only to goods entirely produced in the Soviet Bloc but also extended to goods processed (as distinguished from manufactured) in friendly countries from materials which are of Soviet Bloc origin.

It has not been found possible to estimate the loss which would be imposed on the Bloc by banning such products.

(D) Estimate of the magnitude of other remittances which would be cut off, i.e., support remittances from relatives, remittances for services, other invisibles, etc., as distinguished from payments for imports.

Remittances to the European Soviet Bloc from the United States are estimated to have been $14 million in 1952, $17 million in 1953, and $15 million in 1954. Included in these figures is a substantial amount attributable to gift parcels.

SUMMARY

The estimated economic impact on the Soviet Bloc of an extension of blocking and import controls would therefore appear to be:

Bureau of Census for imports

(in millions of dollars)

Assets (exclusive of indirectly held assets)	$21
Imports denied ('54 basis)	$50 annually
Sales abroad of such exports by the Bloc	$25 annually
Estimated net loss from imports denied	$25 annually
Denial of remittances	$15 annually

gift parcels

There would also be an additional unestimatable loss to the Bloc through the exclusion of those Bloc products which are processed in third countries.

6. ESTIMATE OF ECONOMIC IMPACT ON SOVIET BLOC OF FREE WORLD FINANCIAL (BLOCKING AND IMPORT) CONTROLS

Assumptions and Conclusions

Assumptions

The present discussion is based on the assumption that the multilateral application of financial controls vis-a-vis the Soviet Bloc would encompass the complete denial of exports, as well as a control of other financial transactions comparable to that exercised by the Foreign Assets Control. By their unselective nature, import and transaction controls constitute an ultimate action directed against the entire economy of the target area, and presumably would therefore be invoked only after, or in conjunction with, application of a full embargo on exports. Accordingly, the possible consequences of financial controls will be discussed in terms of a full cessation of trade between non-communist areas and the Bloc. The fundamental interest of the Soviet Bloc in trade with non-communist areas has been focused on the import phase of this trade. The search for vital supplies from abroad, rather than an outlet for surplus domestic production, has hitherto provided the main impetus for economic relations with the Free World. Accordingly, the present discussion will be devoted primarily to the foreseeable consequences of the deprivation of access to imports from the Free World.

With respect to the effect on the Bloc's foreign exchange earnings, detailed comment has been omitted in the light of the following considerations:

In the event of the full application of financial controls by the entire Free World to the Bloc as a whole, the problem of the effect on the exchange reserves of the Bloc would become academic as the present Bloc trade with the Free World is roughly in balance. The impact of such

an action on intra-bloc economic relations would call for a significant reallocation of resources, the nature of which is regarded as outside the scope of this study.

In the event of the full application of financial controls by COCOM countries only, the loss of the modest surplus earnings by the Bloc ($125 million in 1954) from this phase of its trade would not seriously interfere with the procurement of essential goods from non-COCOM areas. Under such circumstances, the Bloc could bring into balance its payments with non-COCOM areas by greater diversification of exports to underdeveloped countries, by marketing more of its raw materials in the non-COCOM industrialized countries, or by the sale of precious metals.

Conclusions

The conclusions reached in the present paper with respect to the effect on the Sino? European-Soviet Bloc of the loss of Free World supplies are as follows:

(1) If full financial controls (i.e., suspension of all trade) were applied by CHINCOM countries to communist China alone, basic revisions and considerable retardation of China's industrialization program would be required. The impact would be most telling with respect to fertilizer, drugs, and machinery spare parts. Non-access to COCOM sources of machinery and chemicals would increase China's demands on the rest of the Bloc, which presumably could be met insofar as the most urgent needs of that country are concerned.

(2) If such controls were also exercised by all non-COCOM Free World countries, the non-availability of raw rubber, either by direct shipment or transshipment through Eastern Europe, would seriously hamper China's rubber industry. Adverse effects would also be felt by the

cotton textile industry, particularly in years of short domestic crops, although strict rationing controls would be expected to cover minimum requirements. The adoption of full financial controls by non-CHINCOM countries would greatly facilitate the enforcement of CHINCOM actions.

(3) If full financial controls were applied by COCOM countries to the entire Soviet Bloc, the inability to import raw metals and semi-manufactures from the West would seriously disrupt Bloc industrial operations. Non-access to machinery and ships from COCOM areas would deprive the Bloc of contact with Western technical innovations and improvements in labor productivity, of supplies of equipment to bolster and balance domestic output, and of a means of freeing certain domestic production facilities for full concentration on military end products. Furthermore, the cessation of legal trade would diminish procurement opportunities for clandestine acquisitions.

(4) In the event of a complete cessation of trade relations between the non-COCOM Free World and the Soviet Bloc, the principal effect on the Bloc would be felt with respect to supplies of industrial raw materials, particularly of natural rubber. Secondary effects would occur in respect to certain foodstuffs (fruit, spices, cocoa, tea) and vegetable fibers (particularly textile products such as wool, jute, and cotton) related to the areas of civilian production and public morale.

Briefly, while the civilian sector of the economy would be materially handicapped by the loss of Free World trade, the Bloc could, for the short term, continue to maintain and improve its military production and to expand basic industrial capabilities.

REWARDING!

Discussion

(a) Traditional Significance of External Trade to Bloc Countries

The countries now comprising the Soviet Bloc were never counted among the leading commercial nations of the world. By reason of their geography and historical development, the principal members of the bloc, Russia and China, were long characterized by predominantly agrarian economies. As largely self-contained economic entities, their participation in world trade was on a comparatively small scale. Their capacity to engage in international trade was limited by a lack of significant export surpluses. Thus, in 1938 China ranked fifteenth in number among the exporting nations of the world, the U.S.S.R. -- twenty-sixth. The principal features of the foreign trade in which these countries engaged over the years consisted, in the main, of an exchange of domestic raw materials, chiefly agricultural, for imported industrial products.

As countries deficient in industrial production, Eastern Europe and China in the past gravitated to the industrial countries of the West, and to Japan in the Far East, as an outlet for their raw materials and as a source for their principal imports. Thus, China's trade with nations outside the current Bloc normally accounted for over 90 percent of its entire foreign commerce. In the case of the U.S.S.R., trade with the West also approached 90 percent of the total; the present satellite countries conducted about 65 percent of their trade with the West European and other industrialized nations.

In the main, recent Eastern European bloc trade with the Free World has been characterized by large scale imports of machinery and metals and

a pattern of exports consisting principally of foodstuffs and raw materials. The export content of China's trade has been basically the same; but its imports have fallen predominantly in the categories of fabricated intermediate industrial products and industrial raw materials.

(b) Significance of East-West Trade in Soviet Bloc Economy

Since their subjection to Communist rule and Soviet forms of economic organization, the countries now in the Soviet Bloc have expanded significantly the industrial sector of their economies. In the process of centrally directed, forced tempo industrialization, the state of farm production was seriously unsettled, chiefly as a result of the shift of considerable labor resources away from agriculture and the disruption of the former system of incentives in the countryside. Despite the rapid expansion of their industrial plant expansion, the bloc countries have continued to draw upon the world economy for a significant volume of economic resources required to raise the level of their industrial self-sufficiency.

Following the extension of Soviet political domination over Eastern Europe at the end of World War II, a major effort was made by the U.S.S.R. to organize the adjacent area into a trading bloc subject to its own effective control. Within this enlarged trading zone at its disposal, the U.S.S.R. proceeded to carry out a directed distribution of economic resources in the interest of achievement of a maximum increase of economic power as defined by Soviet standards. At the same time, the newly annexed border area was made to serve as an instrument for economic warfare against the West. Within the framework of this two-fold objective, trade relations between the individual bloc countries in Eastern Europe and the outside world were drastically cut but not severed.

Beginning in 1950, the first full year after the communist conquest of the Chinese mainland, China began to be drawn systematically into the Soviet Bloc trade orbit. Whereas, prior to communist rule, China's trade with Eastern Europe had been under 10 percent of the total, in 1950 it reached 26 percent, and rose precipitously to 61 percent of total trade turnover in 1951.

Depending upon its utility to the U.S.S.R., the commercial intercourse of each bloc country with the Free World was reduced systematically during the postwar period to a minor proportion of its total international trade turnover. By 1953, for example, the percentage of trade devoted to areas outside the bloc, as officially reported, was as follows for the individual bloc countries: Poland, 29.6; China, 25; Hungary, 23; East Germany, 23; Czechoslovakia, 21.6; Rumania, 15.6; Bulgaria, 14.3; U.S.S.R., "about 20%".

Although confined to a narrow, and presumably safe, segment of total trade, the commodity exchange with the Free World economies has continued to contribute significant economic value to the Soviet Bloc countries. In terms of its relative magnitude, as well as significant economic content, recent East-West trade has loomed notably larger from the standpoint of the bloc nations than from that of their trade partners in the Free World countries. On the one hand, for example, the volume of goods involved in this exchange, valued at approximately 1.7 billion dollars each way in 1954, represented approximately 20% of the total trade turnover of the countries comprising the Soviet Bloc. Measured against the full range of the international commerce of the Free World, on the other hand, the volume of goods exchanged with the Bloc accounted for only 2.2 percent of their total trade.

As far the commodities involved in the exchange are concerned, the records indicate that the Bloc has most commonly required from the Free World countries carefully selected categories of goods of vital importance to its further economic development and, what is more important, available for the most part from the more industrialized Western nations. By the same token, the types of commodities brought by the Bloc into East-West trade channels have generally fallen in the categories of goods marketable chiefly among the nations constituting the Western coalition.

In view of the fact that Soviet Bloc industry functions under a rigid and unpredictable planning system, its requirements for current operational purposes could be met more adequately under conditions of relatively free access to the markets of the outside world where, under normal conditions, it is only necessary to have adequate purchasing power in order to be able to procure any volume of goods, of any specified quality, at fair, competitively determined prices.

From the standpoint of the Free World, the Bloc has represented in recent years a limited or marginal market for hard-to move exports and an alternative (or supplemental) source of raw materials obtainable for soft currency or, in effect, on barter terms.

(1) The Limits of Intra-Bloc Trade

There is a clearly discernible double standard underlying the Soviet approach to foreign trade: the exchange of goods within the Bloc is adjudged as a constructive activity in economic cooperation, while trade with areas outside the frontiers of the Soviet empire is equated with potential economic dependence. On the theory that this official dogma is wholly accepted by partners in the Bloc, the U.S.S.R. has utilized its

dominant position to devise legal instrumentalities and to exert pressure for a maximum expansion of commodity trade inside the Bloc. As a result, by 1949, two-thirds of the foreign trade of the U.S.S.R. was conducted with its own satellites; by 1952 this percentage rose to 80. Within the Bloc as a whole, the net effect has been the same: the scope of commercial contact with the outside world has been contracting steadily. In 1951, non-Bloc trade amounted to 31% of total; by 1953, extra-Bloc trade was further reduced to 20% of the total trade turnover of the Soviet orbit countries.

As presently constituted, intra-bloc trade represents a fairly substantial transfer of goods across national frontiers. It must be recognized, however, as a movement motivated only in part by considerations of comparative economic advantage. In part, too, this trade is compounded of a good deal of cross-hauling of goods from all parts of the orbit, via the U.S.S.R., a kind of movement that is justifiable chiefly on the grounds of increasing the opportunities for penetration by the Soviet Union into the internal economic life of the individual Bloc countries. It is quite apparent, even from the meager official reports, that a substantial proportion of the goods which the individual Bloc countries acquire via the U.S.S.R. are in the nature of re-exports, provided to them by the Soviet trade monopoly in its capacity as the largest trader and self-elected commercial intermediary for the area. Some of these Soviet reexports within its own orbit, to be sure, may originate in other Bloc countries. In these categories are: coal, coke, petroleum, bauxite, synthetic rubber, timber, paper, sugar, fertilizer, vegetable oils, oil cake, zinc, copper, tin, lead, and machinery. Other groups of reexports provided by the U.S.S.R. frequently have their origin in normal world trade

markets. Among these are: wool, cotton, jute, rubber, meats, animal fats, vegetable oils, tea, cocoa, graphite, mica, industrial chemicals, and machinery.

By means of this artificially inflated system of intra-Bloc trade, promoted and partly financed by the U.S.S.R., the individual Bloc countries evidently succeed in meeting the bulk of their foreign commodity requirements. It is reasonable to assume, however, that in order to cover a maximum of intra-Bloc needs through this channel the Bloc governments have to be willing to accept certain of their imports without regard to minimum standards and without the freedom to choose among all available alternatives. In a world in which political power rather than purchasing power speaks with the highest authority, the well-behaved Bloc participant will usually be satisfied with the kind, and amount, of exports the Soviet Union feels it can spare. For example, even a relatively abundant raw material like iron ore, a commodity basic in the Bloc's drive for optimum capacity in steel, has to be procured by several satellites from Free World sources, — from Europe, India, North Africa, and South America.

On the whole, true economic complimentarity appears to a rather exceptional phenomenon within the Bloc. Many of its members, it will be recalled, are in approximately the same stage of industrial development. For this reason, they must continue to turn to the world market for the geographically localized raw materials as well as for industrial goods of the latest technological quality available in the world economy as a whole.

(2) Function of Economic Intercourse with the Free World

As shown by Soviet Bloc practice, trade with the Free World reduces itself in essence to a governmental procurement operation. The chief interest in the world market, on the part of the economic strategists of the Bloc, stems unmistakably from the import side, to the extent that such imports are required to provide added support for domestic program of economic expansion. Exports play a subsidiary, supporting role in Bloc commercial calculations since, in theory at least, surpluses could be prevented in a planned economy by a shift of resources to other areas of production. To the extent, however, that essential goods from the world economy at large continue to be required, exports have to be mobilized by Bloc economic authorities in sufficient volume to pay the costs incurred in connection within the officially approved import program.

For the purpose of conducting this type of controlled foreign trade, within the framework of a centrally directed economy, the U.S.S.R. has devised, and the rest of the Bloc has emulated, a system of trading by government-owned corporations. While this elaborate system of state-trading does not recommend itself for its flexibility or efficiency, it does provide the assurance that (a) all commercial contacts with the outside world will be funneled through a single ministry of the government; and that (b) all activities in this sphere will be coordinated with prevailing domestic economic policies.

Hence, all goods procured by the Bloc countries from the Free World must be considered as constituting a list of official requirements, screened and approved against a standard of essentiality set up by highest political authorities within a Bloc country. To qualify by

this standard, the selected goods must make a contribution towards the development of forced industrialization, strategic self-sufficiency, and maximum military power.

From the standpoint of their end use, recent Bloc imports from the Free World have reflected a strong emphasis on the acquisition of industrial goods, of which machinery is a large component, required for the purpose of stimulating domestic economic development. More than 45 percent of all goods imported by the Bloc in 1953 fell within this broad class of merchandise. The remaining categories of imports fell into two other major groupings, "raw materials" and "foodstuffs", comprising in 1953, respectively, 32% and 16%, of all goods bought by the Bloc in the world market. The emphasis in the China pattern of trade was on raw materials with machinery and metals nevertheless representing a most important segment of the total.

Composition of Bloc Imports from Free World (in %)

	1951	1952	1953
Foodstuffs.............	9.4	9.5	16.2
Raw materials..........	39.7	42.4	32.1
Industrial goods.......	43.4	42.9	45.4
Other..................	7.5	5.2	6.3
Total (in %)........	100.0	100.0	100.0
Total (in millions of dollars)..........	1,688	1,438	1,389

From the standpoint of their economic significance, recent Bloc imports from Free World sources can be identified as serving the following purposes:

1. providing the Bloc economies with a sizeable complement of equipment for use in current exploitation as well as for

technological development beyond domestic capacity to produce;

2. helping to channel into the industrial plant of the Bloc a considerable supply of industrial raw materials, thus contributing towards the maintenance of a higher level of output and towards reducing the idle time of industrial installations and manpower;

3. serving as a source of industrial semi-manufactures have been serving to compensate for planning mistakes of omission, uneconomical management, and shortfalls in the fulfillment of established production quotas;

4. contributing substantial quantities of vital foodstuffs to help maintain minimum diet standards, public health and morale, and labor productivity;

5. relieving the pressure against the commodity resources of some of the major suppliers within the Bloc, chiefly the U.S.S.R.

(3) Capacity for Self-Sufficiency Within the Bloc

The concept of economic development by which the Bloc countries are guided, envisions, among other things, a process of maximum internal expansion of strategic economic capabilities based, in the first instance, upon a coordinated distribution of resources to be found within the area. In this broad development program, the industrial sector of the economy is admittedly the principal beneficiary of all new capital resources, domestic or imported. For this reason, intra-Bloc commodity trade reflects a pre-occupation with the acquisition and redistribution of machinery and raw materials required to keep up a high rate of expansion in heavy industry, by Soviet definition the main source of economic growth.

For a brief consideration of the effective self-sufficiency of the Bloc, it should be most useful, therefore, to focus upon these two broad categories of commodities, industrial machinery and raw materials.

At the present stage, intra-Bloc capabilities for the manufacture of machinery are fairly extensive, if not too well distributed or economically balanced. The three largest producers of equipment in the area (the U.S.S.R., East Germany and Czechoslovakia) appear to be making a conspicuous effort to provide a flow of machinery to the other, less developed countries of the Bloc, especially to China. It is of some interest to note, for example, that the U.S.S.R. has recently identified the dollar value of its annual machinery shipments within the Bloc at 200 million dollars yearly (1953). But shortly thereafter, in an international forum, a Soviet spokesman raised the figure to "three times as much", or 600 million dollars. Despite the extravagant claims made on behalf of the U.S.S.R. as a supplier of machinery, the evidence seems to show that East Germany and Czechoslovakia contribute a larger volume of equipment for distribution through intra-Bloc channels.

Yet, the evidence from East-West trade quite clearly identifies machinery as one of the chief current deficiencies within the Soviet Bloc. The value of imports in this category from non-Bloc sources in 1953 came to about 230 million dollars, or 16.5% of all imports. This figure may be assumed to represent an approved minimal procurement program. conditioned principally by the scarcity of purchasing power, rather than a full measure of the area's total requirements in machinery from the world market. In the light of the Bloc's preoccupation with the development of military equipment, there is a strong suggestion in the evidence that the Bloc continues to be dependent to a very marked degree upon the Free

World for a balanced supply and for new technology in the civilian sector of its machine-building industry.

There is also considerable firm evidence, from the Communist press and from Bloc procurement activities, indicating that industry in the Soviet orbit has been unable thus far to meet in full its current requirements for metals and other material ingredients.

On metals alone, for example, the bloc spent not less than 196 million dollars in 1953, chiefly in the categories of steel exclusive of trans-shipments, semi-manufactures and non-ferrous metals (14% of total imports). In the case of at least two non-ferrous metals, copper and lead, the urgency of Soviet Bloc current needs has been heavily underscored by the special pressure tactics, premium prices, and circuitous channels used by Bloc purchasing agents in recent years to acquire these commodities.

Other essential raw materials for which the Bloc is strongly dependent on outside sources are: natural rubber, textile raw materials, chemicals, hides, vegetable oils, abrasives, cork, sulfur, and a variety of rare metals (cobalt, cadmium, mercury). In 1951, imports of rubber, valued at $205 million, accounted for over 12% of Bloc purchases in the world market; in part this rubber was evidently destined for the Soviet stockpile.

A recent manifestation of weakness in Bloc self-sufficiency has developed in a rather unexpected quarter, namely in foodstuffs. Soviet Bloc imports of meat, fish, dairy products, fats and oils in the Free World aggregated 225 million dollars, or 16% of total imports in 1953. In more recent months, the intake of food products from the outside world has continued, highlighted by large scale purchases of sugar and

meat by the U.S.S.R.

(c) <u>Effect on Soviet Bloc Economy of Free World Financial Controls at Selected Levels of Effective Control</u>

For the purposes of the present discussion the term "full financial controls" is construed to mean that no financial or economic transactions of any kind will be permitted between Free World countries and the entire Soviet Bloc. Consequently, only the movement of goods, services, etc., between the Free World and the Bloc will be considered.

Inasmuch as the main value of East-West trade to the Bloc is generally agreed to arise from the opportunities it affords for the procurement of selected goods essential to Bloc programs of economic de- heavy industrial development velopment and viability, the following examination of the impact of Free World financial controls is focussed on the movement of goods ~~to the Soviet Bloc~~. It is assumed, in this context, that the pressures to find markets for surpluses and to earn foreign exchange are, from the Soviet Bloc viewpoint, incidental to the principal task of acquiring imports.

From the standpoint of the opportunity for western action in the field of foreign trade, it is important to note at this point that the nations currently cooperating in the system of strategic trade controls constitute a substantial factor in the world trade of the bloc countries. In 1954, 48.4% of the Bloc's imports from the Free World and 44.9% of its exports to these areas involved the COCOM countries.

1. <u>Application of Full Financial Controls by CHINCOM to China Only</u>

China's trade with Free World areas has tended to stabilize currently at about 25 percent of her total trade. Of the estimated recorded imports into China from non-communist countries in 1953, totalling

approximately $280 million, goods valued at $200 million were supplied by Western Europe, Hong Kong, and Japan. Adjustments for goods in this total not originating from CHINCOM areas would not basically reduce the relative significance of this trade to communist China. Trade of such magnitude with these industrialized areas is believed to represent both volition and necessity. As to the first, despite the extremely close political and military alignment with the Eastern European sector of the Bloc, it is not unreasonable to assume that China officially encourages some trade with the West as a hedge against complete economic dependency on the Bloc. At the same time because Chinese requirements towards its ambitious industrialization are essentially for investment goods, China must of necessity look to that part of the Free World which possesses a capacity to supply such goods beyond availabilities in the Bloc.

China's principal imports from the CHINCOM area in 1953 were chemicals, pharmaceuticals, dyestuffs, fertilizer, industrial machinery, metals and electrical machinery and spare parts.

These goods are required both for industrial maintenance and expansion and for agricultural developmental purposes, the latter not only for domestic consumption, but also to generate surpluses for trade.

Essential to the expansion of agricultural output is the availability of fertilizer in large quantities. Such an availability of chemical fertilizer could come about only through increased fertilizer production not only in China itself but in other manufacturing countries. Since the European Bloc appears to require its own surplus production of

fertilizer for its own trade with the Free World, China has been looking largely to the West and to Japan as its principal suppliers of chemical fertilizer. Thus, as the Free World supplies approximately half of China's chemical fertilizer requirement in the current period, the cut off of the availability of such fertilizers would be likely to have a very significant adverse effect on the maintenance of China's economic equilibrium.

Drugs and other chemicals have constituted an important component of China's recorded imports from the CHINCOM area in recent years, totalling about $90 million in both 1953 and 1954. Purchases of drugs, particularly of antibiotics, have had a high priority in China's import program, and Bloc availability is both inadequate and uncertain. An effective suspension of trade which would prevent China's acquisition of such drugs from CHINCOM sources would complicate the task of maintaining adequate health standards in the segment of the population essential to the fulfillment of national economic and political programs.

The Five Year Plan places a high priority on increasing the total output of such industrial chemicals as sulphuric and nitric acid, caustic soda, soda ash, synthetic ammonia, calcium carbide and coal tar dyestuffs. Pending the attainment of these goals, which are largely limited by the availability of production equipment, technical personnel, and raw materials, China will have to continue to rely on substantial imports from both the Bloc and non-Bloc sources. The magnitude of these imports from non-Bloc sources, about $50 million yearly, suggests that, except perhaps for some specialties, the Bloc would be in a position to furnish the more essential requirements in the event of a cessation of CHINCOM country trade with China.

SECRET

The Free World has been supplying China with sizeable amounts of metals, machinery and equipment since 1950, ranging from $125 million in 1950 to $20 million in 1952 and $70 million in 1953. The scale of machinery production in the European sector of the Bloc is evidently quite large and varied, and a large portion of China's requirements (of an estimated $600 million yearly) is satisfied from these sources. It must be borne in mind, however, the European Bloc countries are themselves net importers of almost the entire range of machinery. This fact has been reflected in China's continued effort to procure in the West and Japan various types of machinery and equipment both within and outside the embargo categories.

China has needs for replacement parts for a considerable amount of equipment originally installed by Western countries and Japan. This need has been reflected in recent months in a fairly substantial number of CHINCOM exceptions requests. While the value of some of these items is seemingly inconsequential, it may well be that the actual cumulative effect of the denial of such items would have "horseshoe nail" implications.

Present imports into China of metals of CHINCOM area origin are not considered here on the grounds that such metals are embargoed and therefore fall outside legitimate East-West trade.

As to machinery and equipment, aside from the replacement part problem, the conclusion is that while additional requirements on the Bloc for China would produce some inconveniences and involve readjustments in Bloc programs, the comparatively small magnitude of present imports from the Free World, as compared with the extensive Bloc production capacities, and current heavy shipments therefrom to China indicate that the Bloc would find the means to replace the Free World supply.

SECRET

2. Application of Full Financial Controls by Entire Free World to China

In the event of the additional application of full financial controls ~~also by non-COCOM~~ Free World countries, the loss of imports to China, based on 1953 trade, would be well over $100 million.

As distinct from the CHINCOM countries, the categories of goods acquired in these markets are for the most part raw materials, the most prominent of which are rubber and textile fibres.

In recent years China has become a substantial importer of raw rubber from Ceylon (50,000 tons yearly) for its growing rubber goods industry, which has been aiming at self-sufficiency in the manufacture of truck and automobile tires, rubber footwear, and bicycle tires. In part, the imported rubber is forwarded to the European members of the Bloc.

Were China to be denied access to rubber from Free World sources, and there were fairly effective controls militating against transshipment from the rest of the Soviet Bloc, China's rubber industry would be seriously hampered in its operation. The minor amount of natural rubber trickling through to China would not be sufficient, even in the light of an expected adequacy in the supply of synthetic rubber from Eastern Europe, to enable production of a durable standard product.

While China's vital cotton textile industry has been maintained at a high level of production, primarily on the basis of indigenous raw cotton, significant amounts of imported cotton, such as from Pakistan and Egypt, have been required in recent years. In 1952, for example, Pakistan supplied $95 million worth of raw cotton, this constituting China's single largest import item from the Free World.

The cessation of imports from Free World sources would cause serious problems for the textile industry, especially in years of domestic crop insufficiencies. Strict rationing controls would, of course, avert any serious failures in the fulfillment of the minimum requirements.

It would appear from the above that the cessation of trade between the Free World and China resulting from the full application of financial controls would have its principal impact in terms of China's acquisition of rubber, chemicals, drugs, fertilizers, machinery and spare parts. Within these commodity categories the loss of Free World supplies would be felt adversely by the Chinese economy both directly and cumulatively. Such controls, if applied by CHINCOM countries only, coupled with the effective denial of such goods through diversion channels, would be such as to require some basic revisions and considerable retardation of China's industrialization program. The adoption of such controls by other Free World countries would not only greatly facilitate the enforcement of CHINCOM actions, but would operate to deny China access to substituted sources of industrial supplies, and to key raw materials presently furnished the Chinese economy.

3. Application of Full Financial Controls by COCOM to Whole Bloc

The nations who cooperate in the security trade control system also represent the principal sources of supply and markets of chief interest to the Bloc. This is a fact that is admitted, even if grudgingly, by the Soviet leadership. Stalin, acknowledged this fact in October 1952, when he warned the industrialized nations that "matters will soon reach a point" where the Bloc will be able to dispense with Western industrial goods and will, simultaneously, develop new types of surpluses to sell

to the underdeveloped, neutral markets. Until that eventuality is reached, however, the COCOM countries continue to account for about half of the Bloc's commodity trade with the world market. What is more important, they provide the strategic substance of East-West trade, from the viewpoint of the Bloc.

The effect of a full halt in trade with the COCOM countries may, therefore, be expected to be felt by the Bloc chiefly in the following commodity groups: metals, semi-manufactures, foodstuffs, textiles, machinery, and ships. While these types of imports are acquired in relatively modest quantities, supplemental to domestic production, they constitute an important tributary to the pipeline servicing Soviet Bloc industry. The inability to import raw metals and semi-manufactures from the West would, therefore, have a seriously disruptive impact on the Bloc industrial plant by forcing it to depend wholly on an internal supply system that has in the past been found to be inadequate and inflexible, as far as the civilian sector of production is concerned. Even in the case of metals for which there are abundant raw materials in the Bloc, the uneven development of resources, and the frequent shortfalls in planned output, have made it necessary in the past to resort to additional imports in order to keep supplies in harmony with the changing pattern of consumption in industry.

The loss of the present degree of access to the vast pool of machinery and ships available in the COCOM areas would undoubtedly constitute a setback of serious, if indefinable magnitude. As a result of such a loss the Bloc would be deprived, among other things, of: (a) a vital means of maintaining contact with the movement of innovation in

Western technology and improvements in labor productivity; (b) a source of current supply of equipment to bolster and balance domestic output; and (c) a means of freeing certain domestic production facilities for full concentration on military end products.

The absence of regular, legal commercial exchanges with the COCOM countries would, furthermore, diminish opportunities for the acquisition in these markets of a variety of small parcels of vital goods that lend themselves to clandestine shipments to Soviet Bloc destinations.

4. Application of Full Financial Controls by the Free World to the Whole Bloc

In the event of a full break in trade relations with the Free World, the Bloc would feel the effects most acutely in the drying up of supplies of raw materials vital for the operation of a large scale industrial plant. Secondary effects would occur in the areas of foodstuffs and tropical vegetable products not available within the boundaries of the Soviet power orbit. The most prominent among the raw material products in the present range of Soviet Bloc imports has been natural rubber. Although the Bloc can restrict somewhat the tonnage intake of rubber in particular years, as it did in 1954, to a little over 100,000 tons, its average requirements in recent years (1948-54) have been approximately 170,000 tons per annum. In view of the absence of any substitute for this commodity in the Soviet Bloc, the possible loss of access to natural rubber, needed to strengthen the synthetic rubber product, may be expected to interfere rather seriously with the known large scale production of civilian and military vehicles within the Bloc.

The loss of imports in the categories of foodstuffs (fruit, spices, cocoa, tea) and of textile products (wool, jute, cotton) by the Bloc from all sources would be felt above all in terms of morale among the technical elite indispensable for the maintenance of a modern industrial economy.

Without the acquisition of an additional volume of selected goods annually from the Free World, the maintenance of the less favored, civilian and consumer, areas of the Bloc economy would be materially handicapped. Given the present pattern of resource supply and use within the Bloc, however, it must be concluded that the Bloc could, for the short term, without this trade continue to meet the strategic objectives of its economic program, namely the maintenance and improvement of its vast military production and the expansion of its basic industrial capabilities.

5. Impact of Denial of Shipping and Shipping Services

This analysis has not sought to estimate the impact on China and the Soviet Bloc in the event of the denial to them of CHINCOM and other non-Bloc shipping and shipping services (re-insurance, bunkering, repair, etc.). Two views have been expressed in NIE 100-55, "Controls on Trade with Communist China", with respect to the impact of such actions directed at communist China.

One view is that if all non-Bloc shipping and shipping services were denied to the uses of Chinese commerce, the Chinese economy would in the short term be adversely affected and transportation costs increased. Adjustment would probably be made within a reasonable period by shifting a share of China's seaborne trade now carried in non-Bloc vessels to the Trans-Siberian railroad, and provided non-Bloc vessels could be chartered to free Bloc flag shipping for the China trade. If denial affected only CHINCOM flag shipping and services, the Chinese could shift at least part of their seaborne trade to non-CHINCOM flag vessels.

The other view is that the effect would be marked and adverse, and that there would be considerable curtailment of China's foreign trade.

This is based on two considerations: (1) that only a small portion of the China trade could be handled through an increase or readjustment in the use of Bloc shipping; (2) rail transportation facilities within China and between China and the European Bloc probably are not adequate to handle the additional tonnages involved. If denial affected only CHINCOM flag shipping and services the Chinese could shift at least part of their seaborne commerce to non-CHINCOM vessels; but the mitigating effect would not be significant in the light of the limited availability of non-CHINCOM vessels and the anticipated reluctance of these countries to commit their vessels to this trade.

Statistical Appendix

Free World Trade with the Total Soviet Bloc: 1952-1954
(millions of dollars)

	Exports to total Soviet Bloc from						Imports from total Soviet Bloc by					
Year	Free World	Per cent	COCOM	Per cent	Other Free World	Per cent	Free World	Per cent	COCOM	Per cent	Other Free World	Per cent
1952	1,438	100.0	545	37.6	893	62.4	1,626	100.0	756	46.5	870	53.5
1953	1,389	100.0	613	44.1	776	55.9	1,620	100.0	833	51.4	787	48.6
1954 1/	1,720	100.0	832	48.4	888	51.6	1,738	100.0	957	55.1	781	44.9

1/ 1954 preliminary figures.

Source: Adapted from data prepared by the International Analysis Division, Department of Commerce.

Free-World Imports from the Soviet Bloc by Broad Commodity Groups, 1951-1953
(In millions of United States dollars)

Class No.	Commodity	1951	Percent	1952	Percent	1953	Percent
	Imports, total.....	1,883.0	100.0	a)1,625.6	100.0	a)1,620.0	100.0
I	Foodstuffs...............	716.9	38.1	742.3	45.7	665.1	41.1
II	Raw materials(b..........	624.4	33.2	a)554.5	34.1	a)602.0	37.2
III	Industrial goods(including metals)(c..............	307.0	16.3	188.3	11.6	220.1	13.6
IV	Other and unspecified merchandise...........	234.7	12.4	140.5	8.6	132.8	8.1

a) Includes imports from Outer Mongolia.

b) Some "finished"goods are included under Class II as some commodity categories of this group include unknown amounts properly classifiable under Class Number III.

c) Includes ores and base metals.

Free-World Exports to the Soviet Bloc by Broad Commodity Groups, 1951-53
(In millions of United States dollars)

Class No.	Commodity	1951	Percent	1952	Percent	1953	Percent
	Exports, total....	1,687.9	100.0	1,438.3	100.0	1,388.9	100.0
I	Foodstuffs.............	158.8	9.4	136.8	9.5	224.8	16.2
II	Raw materials (including ores)(a.............	669.5	39.7	610.3	42.4	446.1	32.1
III	Industrial goods (including metals)......	732.2	43.4	616.8	42.9	630.2	45.4
IV	Other and unspecified merchandise..........	127.4	7.5	74.4	5.2	87.8	6.3

a) Some "finished goods" are included under Class II as some commodity categories of this group include unknown amounts properly classifiable under Class Number III.

Estimated Total Trade a/ of the Soviet Bloc with the World in 1951
(Millions of U. S. dollars)

Country	Percent Distribution: Total Trade with: Total World	With Free World	With Other Soviet Bloc	In million dollars: Total Trade with: Total World	With Free World	With Other Soviet Bloc
Total Soviet Bloc	100.0	30.6	69.4	11,874	3,632	8,242
U.S.S.R.	100.0	20.3	79.7	3,559	724	2,835
China	100.0	39.1	60.9	2,220	869	1,351
Total satellites	100.0	33.5	66.5	6,095	2,039	4,056
Eastern Germany	100.0	20.1	79.9	1,065	214	851
Poland	100.0	41.8	58.2	1,685	704	981
Czechoslovakia	100.0	39.7	60.3	1,820	722	1,098
Rumania	100.0	22.7	77.3	475	108	367
Hungary	100.0	34.3	65.7	787	270	517
Bulgaria	100.0	8.0	92.0	263	21	242
Albania	100.0	n.a.	n.a.	n.a.	n.a.	n.a.

a/ Exports plus imports.

n.a. - Not available.

Source: Based on percentages of trade distribution reported in official publications of Soviet Bloc countries and data obtained from free world statistical sources.

Estimated Total Trade[a] of the Soviet Bloc with the World in 1953
(Millions of U. S. dollars)

Country	Percent Distribution: Total Trade with: Total World	Percent Distribution: Total Trade with: With Free World	Percent Distribution: Total Trade with: With Other Soviet Bloc	In million dollars: Total Trade with: Total World	In million dollars: Total Trade with: With Free World	In million dollars: Total Trade with: With Other Soviet Bloc
Total Soviet Bloc.....	100.0	19.8	80.2	15,094	3,002	12,093
U.S.S.R...............	100.0	13.7	86.3	5,700	798	4,902
China.................	100.0	25.0	75.0	2,887 c/	722 c/	2,165 c/
Total satellites......	100.0	22.8	77.2	6,508	1,482	5,026
Eastern Germany.......	100.0	23.0	77.0	1,422	327	1,095
Poland................	100.0	29.6	70.4	1,622	480	1,142
Czechoslovakia........	100.0	21.6	78.4	1,576	341	1,235
Rumania...............	100.0	15.7	84.3	812	128	684
Hungary...............	100.0	23.0	77.0	643	148	495
Bulgaria..............	100.0	14.3	85.7	403	58	345
Albania...............	100.0	1.0	99.0	30	b/	30

a/ Exports plus imports.

b/ Less than $0.5 million.

c/ Figures shown for China in this tabulation overstate the value of its trade because of statistical duplication in the free world trade data. A more realistic estimate would be obtained by adjusting this figure downward by about 15%.

Source: Based on percentages of trade distribution reported in official publications of Soviet Bloc countries and data obtained from free world statistical sources.

Free World Imports from the Soviet Bloc, by Principal Commodity Groups, 1951-53
(In millions of United States dollars)

Commodity	1951	1952	1953
Imports, total..................	1,883.0	1)1,625,6	1)1,620.0
Live animals and meat..................	79.5	74.9	92.0
Dairy products........................	31.0	44.7	51.9
Cereals and preparations.............	219.9	346.0	229.0
Fruits and vegetables.................	52.0	69.7	65.3
Sugar and preparations................	56.5	73.1	52.8
Other and unspecified food, beverages, and tobacco........................	112.3	55.8	58.7
Oilseeds..............................	111.5	43.5	68.3
Oils and fats.........................	54.2	34.6	47.1
Wood and lumber, unmanufactured.......	64.0	73.3	105.9
Other and unspecified wood, paper, and manufactures......................	62.5	32.8	27.4
Wool and manufactures.................	24.9	1)11.6	1)31.3
Cotton and manufactures...............	58.6	41.4	44.5
Other and unspecified textile fibers and manufactures..................	78.3	35.9	50.0
Furskins and manufactures.............	55.6	1)43.8	1)40.1
Other and unspecified inedible crude materials and manufactures.........	65.4	70.2	62.5
Fertilizers, crude and manufactured...	22.4	36.7	37.2
Coal and related fuels................	256.2	199.6	173.8
Petroleum and products................	16.6	25.7	56.4
Other and unspecified nonmetallic minerals and manufactures..........	60.7	52.2	50.3
Base metals, ores, and manufactures...	37.5	31.8	32.9
Chemicals (excluding fertilizers).....	60.3	31.5	43.3
Machinery.............................	45.1	38.0	41.8
Transport equipment...................	23.3	18.3	24.7
Other and unspecified merchandise.....	234.7	140.5	132.8

1) Includes imports from Outer Mongolia.

Free World Exports to the Soviet Bloc, by Principal Commodity Groups, 1951-53
(In millions of United States dollars)

Commodity	1951	1952	1953
Exports, total	1,687.9	1,438.3	1,388.9
Dairy products	15.5	19.5	60.3
Fish	25.5	26.5	31.3
Other and unspecified food, beverages and tobacco	94.3	75.8	109.4
Oilseeds, fats and oils	23.5	15.0	23.8
Crude rubber	204.5	158.1	82.0
Wood, cork and manufactures, except paper	58.8	73.2	51.9
Paper, paperboard and manufactures	26.0	25.1	25.3
Raw wool and animal hair	122.3	50.3	103.2
Raw cotton	121.7	197.9	74.9
Other and unspecified textile fibers and manufactures	120.3	86.9	87.6
Other and unspecified inedible crude materials and manufactures	36.9	25.6	26.6
Fertilizers, crude and manufactured	27.4	37.5	24.0
Nonmetallic minerals and manufactures	21.8	14.2	21.1
Iron and steel and manufactures	107.8	77.8	126.9
Base metal ores and other and unspecified base metals and manufactures	43.7	71.1	68.9
Dyeing, tanning and coloring materials	50.1	28.4	37.1
Medicines and pharmaceuticals	41.3	37.7	40.7
Other and unspecified chemicals	51.7	41.3	46.2
Electrical machinery	61.5	54.4	52.2
Mining, construction and industrial machinery, including bearings	74.7	67.0	69.4
Other and unspecified machinery	97.3	58.8	44.6
Ships and boats	63.2	74.4	57.9
Other and unspecified transport equipment	42.3	14.9	7.7
Prefabricated buildings	28.4	32.5	28.1
Other and unspecified merchandise	127.4	74.4	87.8

7. Credit Extension to Soviet Bloc by Free World Countries

(A) Clearing Credits

1. Total Free World credits available to European Soviet Bloc countries through clearing account "swings" have been estimated at $125 million in mid-1954. Available data indicate that nine European countries (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, and Switzerland) account in the aggregate for $95.6 million of these swing facilities placed at the disposal of the European Soviet Bloc. The six COCOM countries included in this group have extended a swing of $47.7 million to the Bloc.

2. It has apparently been the policy of the European Soviet Bloc countries not only to utilize to the maximum, but where possible to exceed the swing facilities made available to them. This is especially true in the case of weaker trading partners who find it more difficult to stop payments to domestic exporters. Thus, at the end of 1953 clearing indebtedness of the Soviet Bloc toward the six COCOM countries in the above group amounted to $50.7 million--$4.4 million in excess of agreed swings. By the end of June 1954, excess indebtedness had risen to $12.1 million (entirely attributable to Italian and Danish credits). Outstanding indebtedness toward these six COCOM countries totaled about $60 million at that date.

3. Actual net swing credits utilized by the Bloc vis-a-vis the nine European countries for which data are available amounted to $27 million in 1953 and $15 million--a continuation of the 1953 rate of utilization--in the first 6 months of 1954. As regards the six COCOM countries included

in this group, their actual net credits to the Soviet Bloc amounted to $36 million during 1953. However, the first half of 1954 witnessed a substantial drop in the rate of Bloc utilization of credits from these countries. Net credits utilized totaled only $9 million during the period and it is estimated that total utilization in the whole of 1954 should not exceed about $15 million.

(B) Other Credits

1. Other credits no longer appear to be a large factor in balancing the accounts of the Bloc with the Free World. The $200 million Swedish loan of 1946 was fully utilized by the end of 1952. Western European countries are no longer providing credits to Poland for the purchase of machinery repayable with deliveries of Polish coal.

2. In so far as information is available it would not appear that any extensive use is being made of export credit and insurance facilities of Western European Governments to finance exports to the Soviet Bloc. There appear to have been only isolated instances of this type of credit being made available to the Bloc in 1954.

8. Effect of Elimination or Reduction of Credits to Soviet Bloc

(A) Cessation of Further Credits - Necessarily tentative estimates indicate that during 1954 COCOM credits to the European Soviet Bloc--almost entirely "swing" credits under payments agreements--financed only a small percentage of an over-all Bloc payments deficit which fragmentary information would place in the neighborhood of 100 $300 million. Cessation of future credits of this type would not appear sufficient to force significant adjustments upon the Soviet Bloc balance of payments--either in terms of reduced imports, increased exports, or sales of gold. Although credits extended by the entire

Free World financed a somewhat larger portion of the apparent Bloc deficit, the limited information at hand would not support the expectation that cessation of all Free World clearing credits could pose a difficult adjustment problem for the Bloc.

(B) Elimination or Reduction of Outstanding Credits

1. With outstanding Free World credits to the European Soviet Bloc at an estimated level of $100 million to $125 million, an immediate elimination of Bloc indebtedness, taken together with a cessation of new credits, would impose a rather substantial burden of adjustment on the current Soviet balance-of-payments.

2. Assuming Soviet desire for continuation of apparent levels of trade in 1954, the Soviet Bloc payments deficit (presumably requiring almost entirely settlement in gold) would rise by about $150 million, or by about 50 percent, in the year in which credits are retired. If the Bloc wished to meet an extinction and cessation of Free World credits by an accommodation of trade levels, this would require either an increase in Soviet Bloc exports or a decrease in imports of about 10 to 15 percent as compared to 1954 levels of trade. The impact of extinction and cessation of further credits by the COCOM countries alone would be somewhat smaller, with adjustments required on the order of 5 to 10 percent of current trade.

9. Soviet Bloc Gold and Credits Problem

(A) Bloc Holdings and Sales

1. Russian gold holdings and production have not been made public since 1935 and such estimates as are available reflect rough projections and conjecture from this uncertain base. Soviet gold stocks have been variously

estimated at from $2 billion to $17 billion and estimates of annual gold production vary within an equally wide range.

2. Estimates of uncertain reliability have placed Soviet Bloc gold sales to the Free World during the years 1949-1952 at an average of somewhat less than $100 million a year. The appearance of the U.S.S.R. on official markets in 1953 has led observers to believe that larger quantities of gold were disposed of in that year. Estimates of sales during 1953 range from $150 million to upwards of $200 million. Little is known concerning the extent of Soviet gold sales in 1954; one estimate puts the volume of sales at about $125 million in 1954.

(B) Gold Sales and the Balance of Payments

1. In 1952, deliveries from Finnish reparations and utilization of the Swedish credit of 1946 appear to have more than offset the estimated Bloc deficit on trade and shipping. Gold sales which may have occurred in that year served either to finance completely unrecorded transactions or to augment balances in Free World currencies.

2. The cessation of Finnish reparations and exhaustion of Swedish credits in 1953 would seem to have resulted in a substantial deterioration in the payments position of the European Soviet Bloc. It would appear that as much as $40 million to $50 million of Soviet gold sales in 1953 may have been required to finance a current Bloc payments deficit with the Free World.

3. Highly tentative estimates place the balance-of-payments deficit of the European Bloc somewhere around $300 million in 1954, substantially greater than any indicated deficit during 1953. It would appear that sizeable Soviet gold sales in 1954 may have been required for financing a current payments deficit and that, in addition, the Bloc may have been forced to effect a drawdown of sterling and other European currency balances in its possession.

(C) Current Position

1. The limited evidence available thus appears to indicate that the European Soviet Bloc entered 1955 with reduced foreign exchange balances and an indebtedness toward bilateral trading partners near or in excess of the limit of permissible "swings." This might suggest that, if available "swings"--and Free World credits over and above them--are not permitted to expand further, a continuation of Free World-Bloc trade in the 1954 pattern would require financing by increasing exports of gold.

2. If all free world countries simultaneously insisted upon immediate termination of their outstanding credits to the Soviet Bloc, the Bloc would have to sell an extra $100 million in gold or significant adjustments in trade patterns would be required. In all likelihood, Soviet gold holdings are such that existing free world credits could be paid off without any significant impact on the Soviet domestic economy.

10. Soviet Bloc Gold Problem

Blocking and import controls directed against the Soviet Bloc by the United States would, of course, include a refusal to purchase gold from the Soviet Bloc. To prevent the Bloc from using its gold elsewhere in the Free World would require the extension of similar blocking controls by other countries. In the absence of such controls our own controls could, to some extent, at least, be frustrated by the indirect sales of Russian gold to the United States through other countries. The remedy would be to apply more drastic controls over gold transactions with third countries than would apply to other financial and trade transactions with such countries.

If the United States were to refuse to purchase not only Soviet gold but any gold from countries which received Russian gold, the action would

be tantamount to the abandonment of the international gold bullion standard, which is basic to the operation of our monetary system as well as international transactions. Under the existing international gold bullion standard the value of the dollar is maintained at a constant relationship to gold through the commitment of the United States to buy and sell gold freely from the monetary authorities of foreign countries at the set price of $35 a fine ounce (plus or minus the Treasury charge of 1/4 of 1 percent). The dollar is kept at a constant relationship with gold in the United States through the Treasury's purchase of newly-mined gold at this price and its sale of gold for legitimate industrial and artistic purposes.

Without substantially modifying our gold standard principles, it would be impossible to prevent Soviet gold transactions with other countries by unilateral United States action. If, however, the other countries of the Western Bloc adopted regulations similar to our own, it would be difficult for the USSR to obtain commodities through the sale of gold in other markets. The only leak of a system of controls adopted by a large number of Western countries would come through illicit sales of gold to the nationals of such countries or through transactions with "neutral" countries, i.e., those which refused to stop exchange and trade transactions with the Soviet Bloc. If the United States continued to purchase gold from these "neutrals", the Soviet would indirectly obtain goods, since these countries could readily remelt Soviet gold and sell it to the United States with their own mint marks.

As a deterrent the United States could refuse to buy gold other than that held under earmark prior to a given date, or gold proved to be newly mined in non-Soviet countries. This would not be a fully effective device since a substantial portion of the world's gold reserves is held under earmark

at the Federal Reserve Bank of New York. Countries desirous of dealing with the Soviets could sell this gold to the United States as they needed dollar exchange and use the Russian gold to maintain reserves abroad. It is, however, doubtful that they would do so if they were uncertain of their ability to resell this gold, and Soviet gold could be driven to a discount in the private markets for gold.

To establish a fully effective control, the more extreme action, which barred gold transactions with the "neutrals" completely or restricted international transactions in gold to countries which followed a policy parallel to our own, could be employed. This would require arrangements modelled on those which existed under the gold declaration of February 22, 1944. Under this declaration the United States announced that it would not purchase and would not recognize the transference of title to gold which the Axis powers might have looted and that the United States would not buy gold physically located outside of its territorial jurisdiction from any country which had not broken relations with the Axis, or which had purchased gold from any country that had not broken with the Axis, or which offered gold which had been released as a result of acquisition from the Axis. Under the war conditions prevailing in 1944, the U. K., the USSR, and other countries adopted this policy. A similar policy applied to the Soviet Bloc could not be expected except under conditions of war, or near war.

In sum, the United States could carry out a policy of reducing the usefulness of gold to the Soviet Union only by a refusal to purchase gold from countries which did not adopt regulations similar to our own. This abandonment of our gold standard ought not to be considered except as an extreme measure.